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No. 97-533

Supreme Court, U.S.
FILED
OCT 27 1997
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

SHELL OIL COMPANY,

Petitioner,

v.

STUDIENGESELLSCHAFT KOHLE m.b.H.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

NATHANIEL D. KRAMER
Counsel of Record

SPRUNG KRAMER SCHAEFER & BRISCOE
Attorneys for Respondent
120 White Plains Road
Tarrytown, New York 10591
(914) 332-5056

Of Counsel:

ARNOLD SPRUNG

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Rule 29.6 Statement

Respondent, Studiengesellschaft Kohle m.b.H. ("SGK"), acts a trustee for the Max Planck Institute for Coal Research. Respondent has no other parent or subsidiary companies.

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Brief in Opposition to Petition for Writ of Certiorari

I. Summary of Reasons for Denying the Writ

A. The decision below, on the question presented, is not in conflict with the decision of any other United States court of appeals. To the contrary, it is in accord with the decisions of four other courts of appeal.

B. The decision below remanded this action to the district court for trial on various issues. Since petitioner has offered additional defenses to respondent's royalty claim, any decision of this court, on the question presented, may turn out to be no more than *dictum* in this action.

C. The decision below correctly applied the law. Nothing in *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969), is to the contrary.

II. Counterstatement of the Case

Petitioner Shell's polypropylene patent license was amended in 1979 to provide Shell with a paid up license under U.S. Patent 4,125,698 to the extent of 450 million pounds of polypropylene per year. Petitioner's Appendix ("App.") 59a at ¶2. After a decision upholding the patent against various challenges to its validity, *Studiengesellschaft Kohle m.b.H. v. Northern Petrochemical Co.*, 784 F.2d 351 (Fed. Cir. 1986), and an injunction entered thereon, Shell sought and obtained a further license from SGK in 1987 on sales beyond its paid up amount in exchange for an agreement to pay a 1.5% running royalty. App. 62a at ¶2.

In an effort to insure that Shell would report on all its polypropylene sales above the paid up amount, and promptly advise licensor of the details of any polypropylene catalyst and process that Shell believed fell outside the license, the parties additionally agreed, in the 1987 agreement, that:

> "With each yearly accounting rendered, SHELL shall specify the amount of Polypropylene produced which it

> considers as falling outside of the license and shall provide SGK, in confidence, with sufficient information to allow SGK to independently evaluate whether or not said production is, in fact, outside of the scope of the license." App. 63a at ¶ 4(d).

For the next several years, Shell's accountings and royalty payments reflected the fact that all of its polypropylene production came within the license. At no time did Shell advise licensor that it was selling any polypropylene "which it consider[ed] as falling outside the license". Nor did Shell provide licensor with any process information.

But in 1992, when Shell was specifically asked for confirmation that it was reporting on all of its polypropylene, it conceded that it was not. It had been repeatedly breaching its agreement by failing to fully report. App. 11a. Needless to say, it had paid no royalties on the unreported polypropylene. For the first time, Shell explicitly refused to pay such royalty. Its license was, therefore, canceled, and this suit was brought in 1993.

The suit claims, *inter alia*, polypropylene royalties going back to 1987 for Shell's failure to account and pay full royalties while the license was in place, plus damages for patent infringement from the time of cancellation. In its Answer, Shell submitted its first challenge to the validity of the licensed patent. In 1995, the licensed patent expired.

In the district court, Shell moved for summary judgment of invalidity. The district court held that claims 1-6 and 14 of the '698 patent were invalid. It also held that licensor's claim for royalties could go forward, regardless of the validity of the patent claims.

The Federal Circuit Court of Appeals affirmed both rulings. On the latter, the court pointed out that under state contract law, "[n]othing in this license made payment of royalties contingent upon the validity of the '698 patent." App. 11a.

Indeed, it would be an "injustice" to allow "Shell to exploit the protection of the contract and patent rights and then later to abandon conveniently its obligations under those same rights." App. 14a.

The Federal Circuit recognized that federal patent law and policy might, in certain limited circumstances, supersede state contract law. App. 12a. But under the facts of this case, the court held it did not. Such federal patent law and policy did not prevent the licensor here from recovering royalties through "the date Shell first challenged the validity of the claims." App. 13a. Moreover, Shell's delay in challenging validity was more likely to "frustrate federal patent policy than enforcement of the contract." App. 14a.

> "By abrogating its notification duty, Shell delayed a timely challenge to the validity of the '698 patent and postponed the public's full and free use of the invention of the '698 patent. Shell enjoyed the protection of the license from 1987 until SGK became aware of the Sea-drift Process. [It was only then that Shell sought] . . . the protection of the *Lear* policies it flaunted for many years." App. 14a.

The court concluded that Shell must abide by its contract and pay such royalties as could be shown to have accrued prior to the date of its challenge to validity. App. 14a-15a. In so ruling, it joined four other circuits that have addressed the same issue. *Ibid.*

III. Reasons for Denying the Writ

A. The Writ Should Be Denied Because the Decision Below is in Accord With the Decision Of Every Other Circuit That Has Addressed the Issue

This court's limited resources are normally directed to cases where there is a conflict among the circuits or between federal and state court decisions. *See* Sup. Ct. R. 10. But here, there is no conflict. The decision below is in accord with those of the four other circuits which have addressed the question. *Hull v. Brunswick Corp.*, 704 F.2d 1195, 1203-04 (10th Cir. 1983); *Rite-Nail Packaging Corp. v. Berryfast, Inc.*, 706 F.2d 933, 936-37 (9th Cir. 1983); *Bristol Locknut Co. v. SPS Technologies, Inc.*, 677 F.2d 1277, 1282-83 (9th Cir. 1982); *American Sterilizer Co. v. Sybron Corp.*, 614 F.2d 890, 896-97 (3d Cir. 1980); *PPG Industries, Inc. v. Westwood Chemical, Inc.*, 530 F.2d 700, 703-07 (6th Cir. 1976).

As those courts have explained:

> "Bristol Locknut [the licensee] received substantial benefit under the licensing agreement. Consequently, Bristol Locknut's obligation to pay the full royalties owed under the contract continued until it challenged the validity of the patents. To hold otherwise, under these facts, would be inequitable and would undermine federal patent law policy." *Bristol Locknut*, 677 F.2d at 1279.
>
> "The actions of PPG in the present case in ceasing the payment of royalties [without challenging validity] were not of the type to prompt an early adjudication of invalidity. It is for this reason . . . that the liability of PPG for royalties did not cease as of the date of termination of payments." *PPG Industries*, 530 F.2d at 706.
>
> "If licensees are permitted to suspend royalty payments without notifying licensors that the reason for the suspension is to question the validity of the patents, they

> will be subject to a . . . temptation to forestall validity litigation." *Hull*, 704 F.2d at 1203.
>
> "[T]he key issue is whether a prompt challenge to the patent follows the licensee's suspension of royalty payments." *American Sterilizer*, 614 F.2d at 897.

In operation, the "challenge rule" applied by the five circuit courts encourages early patent validity determinations in two ways:

* The licensee is encouraged to analyze validity of the licensed patent and, if he finds the patent to be invalid, to discontinue his royalty payments and promptly challenge validity. If he is sued for royalties, he can escape payment for all royalties which might accrue after the challenge, assuming that he can succeed in showing patent invalidity.

* The patentee is encouraged to promptly bring suit where his patent's validity has been challenged and royalties stopped. He knows that there is no point in waiting for unpaid royalties to mount up. The licensee has challenged validity; if he can prove invalidity, a claim for royalties back to the date of the challenge will be fruitless.

Petitioner urges that the Third, Sixth, Ninth, Tenth and Federal Circuits are arrayed against the Seventh in view of the latter's decision in *Kraly v. National Distillers & Chemical Corp.*, 502 F.2d 1366 (7th Cir. 1974). But *Kraly* is not at all to the contrary. It simply decides a different issue.

In *Kraly*, despite a holding of patent invalidity, the district court awarded the patentee four quarters of back royalties, the royalties which accrued until the licensee " 'had repudiated the license agreement and assumed the risk of being found liable for infringing. . . .' " *Id.* at 1372. The Court of Appeals affirmed, approving the decision as an "appropriate

use of judicial power to enforce the terms of a licensing agreement during the period prior to an adjudication of invalidity in which both parties benefited from the agreement." *Ibid.* No issue was raised on whether the timing of the licensee's challenge to validity had any impact on the recoverability of royalties.[1]

B. The Writ Should Be Denied as the Question Presented May Never Have to be Reached in the Instant Action

The issue presented was decided below on an interlocutory appeal under 28 U.S.C. § 1292(b). App. 11a. After its decision, the Federal Circuit remanded, *inter alia*, for a determination of whether, in fact, any royalties were owed. App. 15a. The court also denied petitioner's motion to stay the mandate pending this petition for certiorari. Petition at 2.

Since then, the District Court has denied petitioner's motion for a stay of proceedings pending the filing and resolution of the instant petition for certiorari, and it has issued a further scheduling order providing for trial of this action in February 1998.

Shell has already advised that it will defend against the royalty claim, at trial, on the theory that it has not infringed. Should it prevail on this ground, the district court will never be required to address the question presented herein. Put

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[1] Shell also relies on the district court decision in *Crane Co. v. Aeroquip Corp.*, 356 F. Supp. 733 (N.D. Ill. 1973). But in *Crane*, the patentee was not asserting the challenge rule of the five circuit courts (those decisions had not yet been rendered), but rather a rule that would have precluded any cut-off of royalty accrual until there was a *lawsuit* in which validity was challenged. *Id.* at 740.

The court pointed out that if *this* rule were the law, it would not encourage early adjudication of validity. "[T]he patentee could simply wait until the patent expires and sue for all royalties not paid 'prior' to the litigation." (*Ibid.*) The only thing the licensee could do to prevent such a result would be to "bring a suit for a declaratory judgment that the patent is invalid." *Ibid.*

differently, the review sought herein is on an issue which may never have to be reached in this action.

C. The Writ Should Be Denied Because the Decision Below Correctly Applied the Law—Nothing in *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969), is to the Contrary

A patent license is basically nothing more than a licensee's promise to pay royalties in exchange for a patentee's promise to forbear from doing what the patent law otherwise entitles him to do, namely sue for infringement and potentially collect damages based on a tort standard, sometimes trebled, along with an injunction.

In the instant case, the licensee, Shell, has received substantial benefit under its license, including the agreed upon freedom from an infringement claim during the period from 1987 until 1993. Accordingly, Shell owes all royalties accrued in this period which have not been paid. Since nothing in the parties' agreement warranted the validity of the licensed '698 patent, or otherwise made the payment of royalties contingent upon patent validity, under state contract law, royalties are payable without regard to the validity of the licensed patent. App. 11a-12a.

Under state contract law, for a licensee to avoid royalties for any period, it would have to show that it had, before that period started, unequivocally given up its freedom from an infringement suit by returning to the same unprotected status as an infringer. It could do this by showing it terminated the agreement or, where recognized by the Court's jurisprudence, by showing it "repudiated" the protection of the license. *See, e.g., Kraly, supra*; *Bahamas Paper Co. v. Imperial Packaging Corp.*, 58 F.R.D. 355, 357 (S.D.N.Y. 1973).

But Shell plainly did neither in the instant case. Instead, it avoided exposure on the production it was not paying for by disregarding the provision of its license that expressly required it to tell its licensor, with each annual royalty report,

of any polypropylene it considered as falling outside of the license.

Shell received freedom from tort suit during the period from 1987 to 1993. Under state contract law, it owes all royalties which accrued during that period, without regard to patent validity. *See* App. 11a-12a. Indeed, Shell concedes as much. Petition at 18.

There is no federal patent statute that applies here, and the only precedent of this court even remotely relevant is *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969).[2] But nothing in *Lear* requires that Shell's obligations under state contract law must be abrogated. *Lear* merely requires that the licensee be permitted to challenge patent validity at an early time, so that the public stands to benefit if there is a determination of invalidity.

In *Lear*, the licensee of a patent application discovered apparently anticipatory prior art in 1957 and promptly advised the licensor that since no valid patent should issue on the application, it would refuse to pay further royalties on the bulk of its products. *Id.* at 659. Put differently, it discontinued royalty payments and, at the same time, challenged validity. In 1960, a patent did issue on the application. *Id.* at 660.

In a suit for royalties, the California Supreme Court ruled that the licensee had no contractual right to terminate its

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[2] The other cases cited by Shell are inapposite. For example, *Sears, Roebuck & Co. v. Stiffel Co.*, 376 U.S. 225 (1964) and *Compco Corp. v. Day-Brite Lighting, Inc.*, 376 U.S. 234 (1964) deal with the power of a state to set up a mini patent system under its unfair competition laws. *Blonder-Tongue Lab., Inc. v. Univ. of Ill. Found.*, 402 U.S. 313 (1971) deals with the applicability of collateral estoppel in a patent case. *Brulotte v. Thys Co.*, 379 U.S. 29 (1964) deals with the propriety of requiring a licensee to pay royalties accruing after the expiration of a patent. *Westinghouse Elec. & Mfg. Co. v. Formica Insulation Co.*, 266 U.S. 342 (1924), deals with an assignor estopped to deny validity and the equitable remedy fashioned by the court to ameliorate that estoppel.

license and that it could not avoid payment of royalties by showing that the licensed patent was invalid. In short, despite its early challenge to validity, the licensee was estopped to deny validity of the licensed patent. *Id.* at 661, 656. The court reinstated a jury verdict in favor of the licensor for back royalties.

In reversing, this Court held that in view of federal patent policy, state contract law must give way to the following extent:

1. Licensees are not estopped from contesting patent validity. *Id.* at 669-71.

2. Licensees are not required to continue paying royalties during the time they are challenging patent validity in the courts. *Id.* at 673.

3. The licensee before it was entitled to avoid payment of all patent royalties which accrued after its 1957 challenge to validity, if it could prove the patent was invalid. *Id.* at 674.

But none of these holdings is contrary to that of the Federal Circuit in the instant case. Shell was certainly permitted to challenge patent validity herein. App. 5a-8a. Further, the parties' license was never construed to require that Shell had to pay royalties during the time it was challenging patent validity in the court. Finally, since Shell proved claims 1-6 and 14 invalid, it was entitled to avoid payment of all patent royalties which accrued under such claims after it first challenged validity. App. 11a-15a.

Moreover, as confirmed by the Third, Sixth, Ninth and Tenth Circuits, the court below properly declined to extend *Lear*. It refused to supersede additional state contract rules in the name of federal "public policy". This would be a particularly inappropriate case to extend *Lear*.

1. Shell, unlike the licensee in *Lear*, had a contractual right to terminate, and could have terminated the license agreement

at any time since 1987, so as to avoid further obligations under its license. App. 54a. But Shell chose, instead, to keep silent about its excess production in order to reap the benefits of its license while avoiding a claim by its licensor for royalties. *See* App. 14a.

2. In light of the holding in *Lear*, Shell also had the option of promptly challenging validity so as to bring on a rapid determination of validity. But unlike the licensee in *Lear*, which simultaneously discontinued royalty payments and challenged validity, Shell chose, instead, to delay any challenge to validity, gambling that its licensor would never learn that Shell was exceeding its paid up license. As a result of such delay, the determination of invalidity did not take place in the instant case until 1995, shortly before the '698 patent expired, at a time when it could do little good for the public.

3. Finally, even though Shell's challenge to validity was not prompt, Shell, like the licensee in *Lear*, has nevertheless gained a valuable benefit from its challenge, the right to avoid all royalties which might accrue from and after the date of its challenge.

Conclusion

For each of the above reasons, Shell's petition for a writ of certiorari should be denied.

Respectfully submitted,

NATHANIEL D. KRAMER
Counsel of Record

SPRUNG KRAMER SCHAEFER
& BRISCOE
Attorneys for Respondent
120 White Plains Road
Tarrytown, New York 10591
(914) 332-5056

Of Counsel:

ARNOLD SPRUNG